Tax Hotline

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INDIA BUDGET 2021: STEADYING THE SHIP

The Indian Finance Minister (FM), Nirmala Sitharaman, presented the Union Budget (Budget) of India for the financial year (FY) 2021-22 on February 1, 2021. This was a crucial Budget for the Government, especially against the backdrop the contraction of the GDP by 7.7 percent caused by the COVID-19 pandemic, which is expected to continue to make the road to recovery a difficult one. It appears, however, that the Budget has delivered the goods.

From a reforms perspective, this Budget carries forward the ongoing focus of this Government on increasing administrative ease, transparency, and simplification of legal provisions. In her speech, the FM mentioned the intention of the Government to introduce a new Securities Law code to consolidate laws under the Securities and Exchange Board of India Act, 1992, the Depositories Act, 1996, the Securities Contracts Regulation Act, 1956 and the Government Securities Act, 2007. She also a mentioned an Investors' charter to assimilate the rights of all financial investors across all financial products. The turnover and paid-up capital thresholds for setting up of One Person Companies are proposed to be removed and the residence requirement for sole members is proposed to be diluted. If adopted, a sole member will be required to remain in India for a minimum of 120 days (as opposed to the current requirement of 182 days). NRIs will also be allowed to set up such companies. On the FDI front, the cap on the insurance sector is proposed to be liberalised from the extant 49 percent to 74 percent. This is a welcome move, which will go a long way in developing the insurance sector in the country.

With respect to direct taxes, tax rates largely remain unchanged although the Budget seeks to introduce a number of procedural changes.

Whilst last year saw the introduction of faceless assessments, this year's Budget introduces a faceless Income Tax Appellate Tribunal to simplify the appellate procedure. All hearings before the tribunal are now proposed to take place over video conferencing. To limit prolonged uncertainty of proceedings, the statute of limitations for reopening of tax assessments has been reduced to three years from the relevant assessment year (AY) including for indirect transfers which currently can be reopened for a period of sixteen years from the relevant AY. In an attempt to foster compliance and reporting, the Budget has introduced provisions for application of higher tax rates for non-filers of income tax returns. Further, the Income Tax Settlement Commission has been disbanded, whilst the Authority for Advance Rulings framework has been overhauled.

Substantively, the Budget proposes a slew of amendments to the International Financial Services Centre (IFSC) to further ease operations in the IFSC and to incentivise setting up in the IFSC. These include introduction of a tax holiday for aircraft leasing companies, tax exemption for relocating offshore funds in the IFSC, tax exemption to investment divisions of foreign banks located in IFSC.

To further bolster the start-up ecosystem, the Budget proposes to extend the eligibility for claiming tax holiday and extend the capital gains exemption for investment in start-ups by one more year – March 31 2022.

The Finance Act, 2020 had abolished Dividend Distribution Tax (DDT) to introduce a dividend withholding regime. In furtherance of this move, the Budget proposed to provide that the advance tax liability on dividend income shall arise only after the declaration / payment of dividend and not on accrual. Further, dividend payments to REIT (Real Estate Investment Trust) / InvIT (Infrastructure Investment Trust) have also been proposed to be exempted from withholding tax and lower withholding tax rates under the relevant treaty has now been proposed to be introduced for Foreign Portfolio Investors (FPIs).

The Finance Act, 2020 had also introduced tax exemptions for Sovereign Wealth Funds (SWFs) and Pension Funds (PFs) for income in the nature of dividend, interest or long-term capital gains arising from investments made by them in India in infrastructure facilities. The Budget has rationalised these provisions thereby giving an impetus to SWFs & PFs to make further investment into India. Some of the measures include relaxation for Alternative Investment Funds (AIFs) investing into infrastructure facilities, extension of exemption to SWFs & PFs investing through Non-Banking Finance Company-Infrastructure Debt Fund / Infrastructure Finance Company (NBFC – IDC / IFC), allowing SWFs & PF to borrow & undertake activities for the purpose of monitoring its investment in India. The intent behind this move is to encourage long term stable capital participation from sovereign wealth funds, to replace Government spending in the creation of infrastructure assets and also foster economic relations with such countries.

In a surprise move in last year's Finance Act, 2020, the Government had expanded the scope of the Equalisation Levy (EL) to cover non-resident e-commerce operators making supplies in India. The provisions as they were introduced were ambiguous and created a lot of confusion among stakeholders. Recognising this, this Budget has sought to provide some clarifications such as defining 'online sale of goods' and 'online provision of services', and removing income that is already taxed as *royalty* or *fees from technical services* from the purview of the EL. However, these clarifications have largely missed the mark as the definitions make the ambit of the EL wider and vaguer, and do not clarify whether financial services transactions, B2B transactions, non-profit businesses such as education, healthcare etc. and inter-company transactions fall within the scope of the EL.

On the infrastructure side, the FM recognizing the need for long term debt financing has proposed to introduce a bill to set up a professionally managed Development Financial Institution which will act as a provider, enabler and catalyst for infrastructure financing with the ambition of having a lending portfolio of at least INR 5 trillion in three years' time. The Budget also proposes to make suitable amendment in the relevant legislation to allow debt Financing of InvITs and REITs by FPIs. This will further ease access of finance to InvITs and REITs thus augmenting funds for infrastructure and real estate sectors.

A long-standing demand of the industry has been that of allowing Indian companies to list abroad. While it was expected that the Budget would provide some clarity thereof, no such announcement has been made.

In some interesting developments for the education sector, the Budget reiterated that higher education in India will soon come under a single regulator, which will have a separate department / body each for standard-setting, accreditation, regulation and funding. This is a reiteration of the vision of the National Education Policy, 2020 and the Government is therefore, more determined than ever to streamline higher education in India. On the health care side, the FM announced an overall increase in the healthcare budget by 137 percent to INR 2.23 trillion (inclusive of a dedicated INR 350 Billion for COVID-19 vaccines and more, if required). The Budget promises to be the shot in the arm that the healthcare industry has been looking for. Notably, the *Atma Nirbhar Swasth Bharat Yojana* - a centrally funded healthcare infrastructure development scheme – aims to tackle two key aspects – firstly, to drastically improve access to primary, secondary and tertiary healthcare (along with increased connectivity through the National Digital Health Mission) for a larger population, and secondly, an increased state of preparedness to deal with public health emergencies.

With respect to the energy sector, the FM recognised the issue with Discoms which have been monopolies and mostly government owned entities. It has been proposed to put a framework in place that will enable competition and increase their efficiency. This should create opportunities in energy sector and remove bottleneck in the power generation supply chain.

In summary, the Budget does provide clarity regarding some long-standing issues which should promote certainty and boost foreign investor confidence. The Budget has been focussed on overhauling the tax administrative framework to encourage a trust based system and ease of compliance. However, a number of questions remain unanswered, and time will tell whether and how the promises made will be kept. We have provided below a more comprehensive analysis and further insights on the 2021 Budget proposals. Hope you enjoy reading it.

- Nishith M Desai

NON-TAX CHANGES

InvITs and REITs permitted to borrow

In yet another case of multiple regulators taking contrary positions, InvITs and REITs were facing procedural hurdles when looking to borrow funds. While the securities exchange regulator, SEBI permitted REITs and InvITs to borrow monies from various sources, banks were extremely reluctant to lend to them. Banks were weary since (i) the Indian Trusts Act, 1882 ("**Trusts Act**") did not specifically permit trusts to borrow funds, and the borrowing was generally undertaken via general powers given to trustees; and (ii) the regulators left the decision making with respect to enforceability of the rights of the banks to InvITs and REITs to the lending institutions. It was in this background, that InvITs and REITs have sought clarity on this by way of appropriate amendments to the regulatory framework.

The Trusts Act is not proposed to be amended, probably since this may have far reaching implications covering

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within its ambit not just REITs and InvITs, but even other trusts. However, the Finance Bill has proposed to make amendments in other legislations to cover for the above. These are:

- Permitting InvITs and REITs to borrow: The Finance Bill proposes to introduce a Section 30B in the Securities Contracts (Regulation) Act, 1956, which specifically permits pooled investment vehicles (which includes InvITs and REITs) to borrow from third persons. The proposed amendments further state that the borrowing shall be in accordance with the regulatory framework introduced by SEBI for such borrowings. In addition, the proposed amendment also specifically permits the creation of security interest (in accordance with the trust deed) for the amounts borrowed, and provides that the lender can enforce the security created and proceed against the trust assets for recovery.
- 'Borrower' under RDDBFI and SARFAESI: The concept of person borrowing funds from any banks or financial institution under the Recovery of Debts due to Banks and Financial Institutions Act, 1993, as well as the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 has been expanded to include a 'pooled investment vehicle' (which includes InvITs and REITs) as borrowers. This was extremely critical from a bank perspective, since the lack of enforcement options under these laws severely impede the rights of the banks, and banks were not comfortable with this.

The above should provide the adequate comfort to banks, and should encourage lending to the REIT and InvIT regime.

Hike in FDI for insurance: A long awaited step

The foreign direct investment ("**FDI**") limits for insurance sector in 2014-15 was extended to 49 percent (from the erstwhile 26 percent). The industry sought for further liberalisation of the FDI limits in the sector considering the stringent regulatory framework in place for insurance companies, and the regulatory oversight of the insurance regulator, the Insurance Regulatory and Development Authority of India.

In the budget speech for the budget 2019-20, the Finance Minister had proposed expanding FDI in insurance sector, and permitting 100 percent FDI in insurance intermediaries. Based on this, in February 2020, the FDI regime was liberalized, and 100 percent FDI was permitted into insurance intermediaries. However, insurance companies still were permitted to have only 49 percent FDI, in addition to control being with Indian residents at all times.

The Finance Minister in her Budget Speech has proposed expanding the FDI limit for insurance companies to 74 percent, and permit foreign ownership and controls. The Budget Speech states that the majority of the board of directors and the key managerial personnel shall be Indian residents, with at least 50 percent directors being independent. When the regime was liberalized for insurance intermediaries, conditions were imposed which were ambiguous and broad, and raised significant concerns, especially from a structuring perspective. The fine print for this expansion of FDI from 49 percent to 74 percent is expected in due course. It may be interesting to see the exact checks and balances which are introduced in this regard."

TAX CHANGES

INCENTIVES FOR INTERNATIONAL FINANCE SERVICES CENTRE:

The current Government has been taking various measures to operationalize the International Financial Service Centre ("**IFSC**") and has been providing various benefits to units set up in the IFSC – both on the regulatory and tax front. The IFSC seeks to bring to the Indian shores, those financial services transactions that are currently carried on outside India by overseas financial institutions and overseas branches / subsidiaries of Indian financial institutions. The IFSC Authority has been provided statutory recognition under the IFSC Authority Act to act as a unified regulatory authority to develop and regulate the financial products, financial services and financial institutions located / performed in the IFSC. The establishment of IFSC Authority to act as a single-window for regulating activities in an IFSC should also help build investor confidence through consistency, transparency and clarity in policy measures. The Income-tax Act, 1961 ("**ITA**") provides several incentives to units located in IFSC, *inter-alia* including 100 percent tax holiday under Section 80LA, reduced minimum alternate tax, concessional withholding tax on interest income, exemption from capital gains tax on transfer of specified securities etc. In September 2020, the Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 provided certain tax incentives for Category-III Alternative Investment Funds ("**AIFs**") located in the IFSC to encourage relocation of foreign funds to the IFSC.

The Finance Bill, 2021 ("**Finance Bill**") yet again reflecting the seriousness of the Government in promoting the IFSC seeks to provide several benefits for units established in IFSC:

- Inapplicability of certain conditions under Section 9A: The Finance Act, 2015 introduced Section 9A to the ITA to encourage fund management activity from India and provide safe harbour in respect of offshore funds. Section 9A provides that in the case of an eligible investment fund, the fund management activity carried out through an eligible fund manager located in India and acting on behalf of such fund shall by itself not constitute business connection in India of the said fund. Further, an eligible investment fund shall not be said to be resident in India merely because the eligible fund manager undertaking fund management activities on its behalf is located in India. The benefit under Section 9A is available subject to fulfilment of certain conditions provided in the said section. Practically, the fund management industry has not been able to take advantage of the safe harbour provisions in Section 9A due to the requirements being too onerous or impractical for investment funds.

  The Finance Bill proposes to amend Section 9A to empower the Central Government to notify that any one or more of the conditions specified in clauses (a) to (m) of Section 9A(3) or clauses (a) to (d) of Section 9A(4) of the ITA shall not apply to an eligible investment fund or its eligible fund manager, if the fund manager is located in an IFSC and has commenced operations on or before March 31, 2024. It is important to note that this amendment merely seeks to empower the Government to notify the conditions which may not be applicable to the eligible investment fund or its eligible fund manager located in IFSC. The relaxations notified by the Government would actually determine the extent of the benefit available for the eligible investment fund or its eligible fund manager located in IFSC. Having said this, given that AIFs established in IFSC are considered to be resident of India and should be taxable as per the pass-through provided under Section 115UB of the ITA, it is unclear why the notification under Section 9A will be relevant for AIFs established in IFSC.
- Provisions for transition of offshore funds to IFSC: The Finance Bill proposes to provide for a tax neutrality in case of relocation of offshore funds to the IFSC. In this regard, it is important to take note of the following terms proposed to

be defined by the Finance Bill:

a) Original Fund: Original fund has been defined to mean a fund established outside India, which collects funds from its members for investing it for their benefit and fulfils the following conditions:

- the fund is not a person resident in India;
- the fund is a resident of a country with which India has a tax treaty or is established in a country or a specified territory as may be notified by the Central Government in this behalf;
- the fund and its activities are subject to applicable investor protection regulations in the home country where it is established or is a resident; and
- fulfils such other conditions as may be prescribed.

b) Resultant Fund: Resultant fund has been defined as a fund established in India in the form of a trust or a company or a limited liability partnership, which has been granted a certificate of registration of Category I / Category II / Category III AIF and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012 ("**AIF Regulations**") and is located in an IFSC.

c) Relocation: Relocation has been proposed to be mean transfer of assets of the *Original Fund* to a *Resultant Fund* on or before March 31, 2023, where consideration for such transfer is discharged in the form of share or unit or interest in the resultant fund to the shareholder or unit holder or interest holder of the original fund in the same proportion in which the share or unit or interest was held by such shareholder or unit holder or interest holder in such original fund.

The Finance Bill has proposed the following provisions to provide for tax neutrality:

- Exemption from capital gains tax from transfer of capital asset in a *relocation* by the *original fund* to the *resultant fund*. This provision essentially seeks to exempt capital gains arising on transfer of shares of an Indian companies and other Indian securities held by an offshore fund to an AIF located in IFSC. However, the consideration for such transfer has to be discharged in form of allotment of shares / unit in the AIF located in IFSC to the shareholder / unit holder of the offshore fund in the same proportion which such shareholder / unit holder had in the offshore fund. While the provisions seem to cover a swap of shares of Indian securities in lieu of units of the AIF in IFSC, it is unclear as to how such swap will happen without the offshore (original) fund getting units of the AIF in IFSC;
- Exemption from capital gains tax from transfer by a shareholder / unit holder, in a relocation, of capital asset being share / unit held by him in the original fund in consideration for share / unit in the resultant fund. This provision seeks to exempt the transfer at the shareholder level from capital gains tax on account of indirect transfer provisions;
- Exemption from capital gains tax arising or received by a non-resident investor, on account of transfer of shares of an Indian company by the resultant fund (AIF in IFSC) which were acquired by the resultant fund pursuant to relocation and where the capital gains on such transfer would originally not been subject to tax had the relocation not taken place. This provision seeks to place the non-resident investor at par while exiting from an offshore fund where the exit was not subject to tax in India (example on account of grandfathering under provisions of a favourable tax treaty) vis-a-vis exiting from an AIF in IFSC;
- Provisions of Section 79 are also proposed to be amended to allow the Indian company the benefit of set off and carry forward of loss to the extent the change in shareholding has taken place on account of relocation;
- Lastly, corresponding changes have also been proposed in the provisions of Section 56(2)(x) of the ITA.

While these changes are welcome, it may be helpful to clarify certain other industry asks for AIFs in IFSC. A clarification on non-classification of an AIF in IFSC as a member of an association of person ("**AOP**") will provide certainty to fund managers and investors in situation of AIFs in IFSC which co-invest alongwith domestic AIFs. Further, incentives for capital gains tax on exits by AIFs in IFSC for investments made in initial period of three years may provide certain additional benefits to establish AIFs in IFSC. Lastly, while a robust taxation regime has been introduced for Category III AIFs in IFSC, given that a Category III AIFs in IFSC would be required to obtain a foreign portfolio investor ("**FPI**") license as well, it is unclear how tax provisions as applicable to Category III AIFs and FPIs will work in parallel with each other.

- Incentives for offshore banking units: The IFSC Authority has recently announced the IFSC Authority (Banking) Regulations, 2020 in supersession of the scheme for setting of IFSC Banking Units formulated by the Reserve Bank of India. The Finance Bill proposes to provide the following exemptions to the offshore banking units ("**OBU**") located in IFSC:
  - Exemption of any income accrued or arisen to, or received to the investment division of OBU from tax. In this regard, the Finance Bill proposes to define the investment division of OBU to mean an OBU which has been (i) granted a certificate of registration as a Category III AIF and is regulated under the AIF Regulations or which has commenced its operations on or before the March 31, 2024 and (ii) fulfils such conditions including maintenance of separate accounts for its investment division, as may be prescribed.
  - Exemption of any income accrued or arisen to, or received by a non-resident as a result of transfer of non-deliverable forward contracts entered into with an OBU located in IFSC from tax.
- Incentives for aircraft leasing: The IFSC Authority has recently released a consultation paper on the proposed IFSC Authority (Aircraft Leasing) Regulations for public comments. In order to have a competitive tax regime for aircraft leasing in the IFSC, the Finance Bill proposes the following:
  - Extension of tax holiday to income arising on transfer of aircraft or aircraft engine by a Unit located in IFSC to a domestic company engaged in the business of operation of aircraft, before such transfer subject to condition that the Unit has commenced operation on or before the March 31, 2024;
  - Exemption of any income of a non-resident by way of royalty, on account of lease of an aircraft in a previous year, paid by a unit of an IFSC if the unit (i) is eligible for deduction under the Section 80LA of the ITA for that

previous year; and (ii) has commenced its operations on or before the March 31, 2024.

AMENDMENTS TO TAXATION OF SOVEREIGN WEALTH FUNDS & PENSION FUNDS:

In order to promote investment by certain Sovereign Wealth Funds & Pension Funds ("**SWFs & PFs**"), which are in the form of long term stable capital, the Finance Act, 2020 ("**FA, 2020**") exempted income of an SWF & PF that is in the nature of dividend, interest or long-term capital gains arising from an investment made by it in India in infrastructure facilities as defined under the under Section 80-IA (4) of the ITA. The aforesaid income is exempt if it is made in a company or enterprise carrying on the business of developing, or operating and maintaining, or developing, operating and maintaining any infrastructure facility. The benefit of the provision is also allowed if the SWFs & PFs made investment through Infrastructure Investment Trusts / Real Estate Investment Trust ("**InvITs / REITs**") and AIFs. In case of AIFs, the exemption is allowed to SWFs & PFs if their investment has been made through Category I / II AIFs which have 100 percent investment into entities engaged in 'infrastructure facility' as defined under the ITA. While the exemptions were a welcome move and positive for the industry, numerous concerns were raised on the practicality of some of the conditions that were laid out for SWFs & PFs to avail of the exemptions.

Following representations received by the stakeholders on this subject, the Finance Bill has proposed rationalisation of the existing provisions. Proposed amendments in this regard are as follows:

- *Investment in AIFs*: The Finance Bill proposes to (i) relax the condition of AIFs investing 100 percent into infrastructure facility to not less than 50 percent; and (ii) to allow AIFs to invest in InvITs. Therefore, exemption would be allowed even if the AIF into which the SWF / PF invests till such time that the AIF has invested atleast 50 percent into an infrastructure facility or in an InvIT.

  This comes as a welcome move as it allows AIFs flexibility to invest in diverse portfolio without being restricted to investment in infrastructure facilities. Further, while allowing exemption in case of investment by the AIF into an InvIT is also a step in the right direction, there is lack of clarity on whether an AIF can invest in an InvIT in the first place under the AIF Regulations.

- *Extension of exemption to SWFs & PFs investing through a holding company:* The Finance Bill proposes to extend the exemption available to SWFs & PFs in cases where the investment into infrastructure facility is made by such SWFs & PFs through a holding company. In order to avail the benefit, following are the conditions that are to be fulfilled: (i) the holding company should be a domestic Indian company; (ii) it should be set up and registered on or after April 1, 2021; (iii) 75 percent or more of its investment has been made in one or more infrastructure companies.

  This is a welcome move which enables SWFs and PFs to invest into holding company structures. However, SWFs and PFs may be unable to monetise by investing into existing holding company structures which may have invested in multiple infrastructure assets since the provision requires that such a holding company should be set up on or after April 1, 2021. Secondly, infra assets are generally held in a Special Purpose Vehicle ("**SPV**") which is wholly owned by a promoter holding company. There was exemption available to SWFs & PFs only if the investment was made directly in the SPVs which is generally not possible. The exemption should have been provided even if the investment was made into the promoter holding company. However, the proposed amendment requires the SWFs & PFs to set up a holding company in India which can invest in infrastructure facilities. This move does not address the concerns of the SWFs & PFs and infact increases compliance burden for the SWFs & PFs who will have to set up and manage entities in India which will be subject to Indian laws and compliances.

- *Extension of exemption to SWFs & PFs investing through Non-Banking Finance Company-Infrastructure Debt Fund / Infrastructure Finance Company ("**NBFC – IDC / IFC**"):* The Finance Bill also proposes to extend the exemption available to SWFs & PFs in cases where the investment into an NBFC – IDC / IFC provided that the NBFC – IDC / IFC should have minimum 90 percent lending to one or more infrastructure entities in which investment can be made under these provisions to avail exemption. Presently, SWFs / PFs are not allowed to invest in NBFC-IFC / IDF

- *Proportionate exemption in tax:* Considering the above rationalisation wherein AIFs, holding company and the NBFC – IDC / IFCs do not need to invest 100 percent into infrastructure facilities, a proportionate exemption has been allowed to the SWFs & PFs investing through such entities. This was a necessary corollary against the extension of exemptions that have been allowed and should result in more flexibility which would in in turn would provide more investment by the SWFs & PFs into infrastructure facilities in India through the various routes that have been made available.

- *Loan or borrowings by SWFs & PFs:* Under the current provisions, one of the conditions for SWFs & PFs to fulfil in order to take benefit of the provision is that the earnings from the investment do not give any benefit to any private person. Due to this restriction, SWFs & PFs are not allowed to take loans or borrowings or deposit to make investments. The Finance Bill proposes to rationalise this condition by allowing SWFs & PFs to take loans and borrowings provided that they are not used for the purpose of making investment in India. It is also proposed to provide that the condition regarding no benefit to private person and assets going to Government on dissolution would not apply to any payment made to creditor or depositor for loan taken or borrowing which have been used for purposes other than for making investment in India.

- *Commercial activity*: Currently, SWFs & PFs are not allowed to undertake any commercial activity whether within or outside India. The Finance Bill proposes to remove this condition and replace it with a condition that SWFs / PFs shall not participate in day to day operations of the investee companies. It has been further clarified that appointing director and executive director for monitoring the investment would not amount to participation in day to day operations. Further, the term "investee" has been proposed to mean a business trust or a company or an enterprise or an entity or a category I or II AIF or an InvIT or a domestic company or an NBFC – IFC / IDC, in which the SWF or PF, as the case may be, has made the investment, directly or indirectly, under the provisions of the ITA.

  This is positive move from the position as it stands today since SWFs & PFs were restricted from carrying out commercial operations even outside India. Further, while SWFs & PFs were permitted to set up a monitoring mechanism, they were not permitted to appoint executive directors in the investee company or participate in the decision making process or control. Such restrictions practically meant that there could be no proper monitoring mechanism. While any investor has information rights under its transaction documents, it in no way provides for direct monitoring of its investments, and the ensuing clarifications proposed by the Finance Bill are indeed welcome.

The Finance Bill also proposes to provide an additional exemption to PFs. Under the current provisions, a PF can take benefit of the exemption, *inter-alia*, if it not liable to tax in its home jurisdiction. The Finance Bill clarifies this position and proposes that if the PF is liable to tax but exemption from taxation for all its income has been provided by the foreign country under whose laws it is created or established, then such PF shall also be eligible for exemption under these provisions. You can read more about this proposed amendment in the 'Liable to tax' section.

LIABLE TO TAX – MIND THE GAP

The interpretation of the term "liable to tax", which is the lynchpin of the definition of a "resident" in tax treaties based on the OECD Model Tax Convention on Income and Capital ("**OECD Model**"), has been the source of some litigation in India in the past. The issues examined by the courts include: Is a tax-exempt person such as a pension fund or a charitable institution "liable to tax" under the laws of the state which exempts it?[1] Whether a person who earns only income which is tax-exempt in a state could be regarded as being "liable to tax"?[2] Whether a person established in a state with no income tax law could be regarded being "liable to tax" therein?[3] Whether a person who is liable to tax, but not on income, but another tax [listed in Article 2 (Taxes Covered) of the tax treaty] is considered to be a treaty resident?[4]

The Budget has attempted to provide what appears to be an exhaustive definition of the term "liable to tax" in Section 2(29A). Under this definition, a person is liable to tax if "there is *a liability of tax* on such a person *under any law* for the time being in force in any country, and shall include a case where subsequent to imposition of tax liability, an exemption has been provided" (emphasis supplied).

The reference to "a liability of tax… under *any* law" appears to not only codify, but also expand upon, the decision of the Bombay High Court in *Chiron Behring*.[5] In this case, a fiscal transparency established in Germany was liable to trade tax, but not income taxation. The High Court noticed that Article 2 of the Germany-India tax treaty listed the trade tax as one of the taxes covered, and therefore, considered liable to tax. The decision has been criticised,[6] since the trade tax applied to all trading operations carried on in Germany. However, it was not levied on a person "by reason of domicile, residence, place of management or any other criterion of a similar nature", which was the threshold under Article 4 of the tax treaty. The new threshold introduced by the Budget for a person to be considered to be liable to tax in a country appears to be much lower than the OECD meaning of the term employed by tax treaties. The phrasing "*a* liability to tax on a person" appears to expand the interpretation in *Chiron Behring (supra)* insofar as it would not require a tax to so much as be listed as a covered tax under the equivalent of Article 2 of the OECD Model. Literally, that wording also appears to lower the threshold below the requirements of Article 4 of the OECD Model to an extent that an impersonal liability to tax may render a taxpayer to be a resident of contracting state. It is unlikely that such a result may have been intended, lest the literal interpretation lead to a seemingly absurd result that a taxpayer should qualify as a treaty resident of every state in which it pays any tax whatsoever.

Whilst the term belongs to the realm of tax treaties essentially, "liable to tax" has also been adopted – in a similar context – in Section 6 and Section 10(23FE) of the ITA. However, the Memorandum to the Finance Bill appears to suggest that the definition has been inserted also for the purposes of tax treaties concluded under Sections 90 or 90A of the ITA. Therefore, India appears to be lowering the threshold for non-residents to claim tax treaty entitlement through the ITA, even if it may not be intended by the treaty itself.

The term "liable to tax" and has a long history in the context of tax treaties since its adoption in the 1963 OECD Draft Convention, and has acquired the meaning of "comprehensive taxation" in a state within the "international tax language", although it is less than certain as to how comprehensive is comprehensive enough. The phrase "a liability of tax" may also be interpreted as meaning any liability to tax, thus lowering the international threshold.

However, not all aspects of the definition may be viewed as lowering thresholds for taxpayers. The term "a liability of tax on a person" may be interpreted as being different from a person being "liable to tax". It may be interpreted to imply a primary obligation to actually pay tax. Although the latter part of the definition, which states that the term includes "a case where subsequent to imposition of tax liability, an exemption has been provided". Consequently, the definition may be interpreted to require an initial imposition of tax so as to exclude persons (like pension funds, charities and other exempt organisations) which are never required to pay any tax in the first place. This would be an additional threshold than what is intended in tax treaties.

Such an interpretation would be a departure from the international consensus on the meaning of the term "liable to tax" for tax treaty purposes. It would also raise the question about how far domestic law changes to "undefined terms" in tax treaties may influence their interpretation for tax treaty purposes under provisions similar to Article 3(2) of the OECD Model. For instance, Explanation 4 to Section 90 of the ITA states that any treaty terms that are not defined under the treaty but are defined under domestic law would derive their meaning from the domestic law definition.

It appears that there might be significant gaps between the intention and text of the law, which may not augur the Finance Ministry's motto of reducing litigation and inducing certainty. Perhaps, all concerned might profit from a reconsideration of the definition to bridge the gaps between policy and law.

EQUALIZATION LEVY EXPANSION: OVERBROAD, RETROACTIVE, AMBIGUOUS AND PAYABLE ON A 3RD PARTY SELLER'S INCOME

The Finance Act, 2016 introduced the equalization levy ("**EL**") at rate of 6 percent on consideration for provision of "specified services" received or receivable by non-residents from Indian residents or non-residents having a permanent establishment ("**PE**") in India ("**2016 EL**"). The FA, 2020 expanded the scope of the EL to cover non-resident e-commerce operators making supplies in India or having a nexus with India by imposing a 2 percent EL on the amount of consideration received or receivable by an "e-commerce operator" from "e-commerce supply or services" made or provided or facilitated by or through it to specified persons ("**Expanded EL**"). The 2016 EL and the Expanded EL are hereinafter collectively referred to as "**EL**". The manner of introduction of the Expanded EL (without any prior debate or consultation) was widely criticized by the industry and the expansive language of the provisions created several interpretational issues.

The Memorandum to the Finance Bill notes that the Government felt the need to provide certain clarifications to correctly reflect the intention of certain provisions of the Expanded EL. In this regard, Finance Bill has made the following three changes to the Expanded EL retroactively, with effect from April 1, 2020:

- Payments which are taxable as royalty or fee for technical services ("**FTS**") are not subjected to EL /Expanded EL.
- *Online sale of goods* and *online provision of services* has been defined very widely.
- Expanded EL has to be paid on a gross basis henceforth and not on a net basis, which was possible earlier.

Non-resident companies cannot be expected to be prepared for these retroactive changes and it is unfair to companies that have conducted a year of operations to be subject to retrospective taxation in this manner. The detailed analysis is set out below along with legacy issues which remain unclarified.

Non-applicability of EL on considerations which are taxable as royalty or fee for technical services:

- There was an overlap of the scope of the EL with transactions that are currently covered within the scope of royalty and FTS. While, the EL provisions provide an exclusion from application of EL in case where the non-resident has a PE in India and specified service or the e-commerce supply or services (as the case maybe) is effectively connected to such PE ("**PE exclusion**"), the PE exclusion would not apply in case of a source-based payment subject to withholding tax in India independent of the existence of a PE. In such a situation, the same income can be subject to the EL and withholding tax on royalty / FTS under the ITA where the payer withholds tax in abundant caution. Also, given that the same transactions could be covered under the ambit of royalty / FTS and EL provisions, there was an opportunity for arbitrage to choose between the payment of 2 percent EL with no deductions or credits available under the relevant tax treaty, and the payment of 10 percent tax on royalty / FTS, possibly with relief from double taxation under the relevant tax treaty.
- The Finance Bill clarifies that if the consideration received or receivable for specified services and for e-commerce supply or services are taxable as royalty or FTS under the ITA, read with the notified tax treaties, then such consideration should not be taxable under the EL provisions.
- While this is a welcome clarification, it is important to note that the definition of royalty / FTS is narrower under tax treaties and essentially this amendment proposes to levy EL on transactions which do not come under the ambit of royalty / FTS under the tax treaties. Further, given that the implementation of the Significant Economic Presence ("**SEP**") provisions under Section 9 of the ITA has not been deferred under the Budget, in case the thresholds for SEP provisions are notified by the Government there maybe added confusion on the application of the SEP provisions vis-a-vis the EL provisions in the future, particularly if a company is operating from a non-treaty jurisdiction.

Definition for "*online sale of goods*" and "*online provision of services*":

- The Expanded EL applies on "e-commerce supply or services" which has been defined to *inter-alia* include "online sale of goods" or "online provision of services". The use of the word "online" before sale of goods or provision of services, in the definition of "e-commerce supply or services", may lead to unintended consequences wherein the mere fact that a component of sale of goods or provision of services is undertaken online would be enough to bring the entire transaction within the ambit of the Expanded EL. Further, in the absence of any indication of legislative intent for expanding the scope of the EL, it was difficult to interpret the provisions of Expanded EL. Particularly, when under Sale of Goods Act, 1930 a sale of a tangible good is typically completed on delivery, whether the mere act of ordering a good online would make it an "online sale of goods" was ambiguous.
- The Budget proposes to define the terms "online sale of goods" or "online provision of services" to include one or more of the following online activities, namely:

  (a) acceptance of offer for sale; or

  (b) placing of purchase order; or

  (c) acceptance of the purchase order; or

  (d) payment of consideration; or

  (e) supply of goods or provision of services, partly or wholly;";
- Like other definitions under the Expanded EL provisions, the Finance Bill has defined the terms "online sale of goods" or "online provision of services" very broadly, so much so that the Expanded EL may now be applicable even if part of a transaction is conducted online. It must be noted that the amendment proposed by the Finance Bill does not clarify the meaning of "goods" or "services" but only expands the scope of "online sale of goods" or "online provision of services". It is no more necessary for the entire or substantial transaction to be concluded or effectuated online, but the mere placing of a purchase order (without payment of consideration, or conclusion of sale); or the mere acceptance of an offer for sale / purchase order may also be brought within the ambit of the Expanded EL. Instead of providing any clarity, this definition is likely to create further uncertainty for taxpayers.
- Illustratively, as per sub-clause (d), even if the entire sale is concluded offline, but simply the consideration is paid online; or as per sub-clause (e) even if the entire sale is concluded offline but only the delivery of such service takes place online, the Expanded EL may be applicable in both such cases. This could also impact payment gateways and payment aggregators, even though they may only be facilitating online payment for a completely offline transaction.
- Also, subclause (e) widens the scope too broadly, so as to bring transactions where only an element of the transaction might be online, while the entirety of it remains offline. This is bound to cause further confusion within the industry followed by increased uncertainty. The confusion between *online* and *offline* has been further accentuated, as even a good or service which is essentially not an online good / service to begin with, will now be taxable under EL provisions, merely because any part of the sale might have taken place online. The ideal requirement for a transaction to have some substantial significance online is now gone, as even if the underlying transaction is offline, it will still be taxable under the Expanded EL provisions. For instance, an underwriting service with respect to ticket refunds when a concert gets cancelled is not a digital service. However, if the customer is able to claim a refund over an email or by uploading a document onto a platform, under the new amendments, such a

transaction may be covered since a portion of it is conducted online.

Scope of "*consideration received or receivable from e-commerce supply or services" defined*:

- The Expanded EL applies on consideration received or receivable from e-commerce supply or services. Earlier, the Expanded EL provisions did not provide the meaning of "consideration". The Finance Bill now proposes to define the scope of "consideration received or receivable from e-commerce supply or services" to include the below:

  (a) consideration for sale of goods irrespective of whether the e-commerce operator owns the goods;

  (b) consideration for provision of services irrespective of whether service is provided or facilitated by the e-commerce operator"

- This has the potential to have a significant impact on marketplaces operated by the e-commerce operators since the Expanded EL is now likely to apply on the total value of the sale of goods or provision of services facilitated by them as opposed to being charged only on any commission earned by the platform.
- Thus, this is one of the more potentially impactful amendments. Further, it also may be the case that as a consequence, the marketplace would be required to pay taxes not only on their income but also on the income of the 3rd party sellers. This is an indirect way of taxing the income of the 3rd party sellers which is onerous to the marketplace.

Clarification on income-tax exemption:

While the Expanded EL provisions were made applicable from April 1, 2020, the ITA provides that any income arising from any e-commerce supply or services made or provided or facilitated on or after April 1, 2021 and chargeable to EL is exempt from income-tax. The Finance Bill proposes to correct this mismatch to provide for income-tax exemption on any income arising from any e-commerce supply or services made or provided or facilitated on or after April 1, 2020.

Missed Opportunities and open issues:

The proposed amendments to the provisions of EL are unlikely to provide any significant certainty or clarity to taxpayers. Further, the Government has also failed to clarify several other open issues in relation to taxation of digital transaction:

- Scope of Expanded EL: it is unclear whether the Expanded EL will be applicable on provision of services by not-for-profit organizations including but not limited to education institutions providing online education, healthcare services etc., business to business transactions, inter-company transactions, financial services (banking, insurance) transactions etc.
- Transaction between two non-residents: The Expanded EL also applies on transactions between two non-residents ("**NRs**") under "specified circumstances". The definition of "specified circumstances" provided in the Expanded EL provisions creates further confusion as it uses the word "and" in between the two limbs, which could mean that Expanded EL only applies where the sale of advertisement by a NR operator to another NR also involves the sale of data which does not make sense. While it was previously thought of as a legislative drafting error, it has not been changed or amended under the Finance Bill. This implies that for a transaction under "specified circumstances" to be subject to Expanded EL, the fulfilment of both these conditions would be necessary, i.e., there should be sale of advertisement which targets customers resident in India (or Indian internet protocol address) and there should also be sale of data collected from a resident Indian (or Indian internet protocol address). This is specifically relevant for the extra-territorial application of Expanded EL on transactions between two NRs, which had been heavily criticized so far.
- Meaning of sale of data: While the definition of "specified circumstances" uses the term "sale of data", the Government has not clarified whether it covers only raw data or processed data. Given that generally, data processing is not undertaken from India, it may be possible to argue that Expanded EL should not be applicable on sale of processed data as such data loses nexus with the consumer in India and assumes an identity separate from the raw data originally collected from the Indian resident. Further, there is no guidance with respect to whether only data collected in that particular year would be considered or historical data sets would also be considered, even if they have not been moved outside of India.

Impact on USTR proceedings

The Office of the United States Trade Representative ("**USTR**") has found that the Expanded EL to be actionable under the Trade Act of 1974 on account of *inter-alia* obligating US companies to pay additional taxes, forcing US companies to undertake costly compliance measures and subjecting US companies to double taxation and being inconsistent with international tax principles. While the report does not mention any measures in response to the EL; any retaliatory tax could possibly be aimed against Indian tech companies and software service exporters. Additionally, there is an India-USA trade deal stuck in the pipeline, the negotiation of which could be impacted by the findings of the report.

The amendments proposed by the Finance Bill do little to help India's case before the USTR as they create more uncertainty and potentially increase the tax impact on non-resident e-commerce operators.

TAX DEDUCTED AT SOURCE UNDER SECTION 194Q

The Finance Bill proposes introduction of a new section, Section 194Q, providing for a Tax Deducted at Source ("**TDS**") on purchase of goods with effect from July 1, 2021. The applicability of the Section has been explained below:

Liability of Collection (Tax Incidence)	(i) Falls on the Buyer (ii) To be deducted while paying the Seller (resident Indian)	"Buyer": [Explanation to Section 194Q(1)] a person whose turnover, total sales or gross receipts from the business carried on by him exceeds the set threshold, in the financial year ("**FY**") immediately preceding the FY in which purchase of goods is made. (Can also include a non-resident person if and in accordance with notification by the Central

		Government).
Applicability threshold for Buyer (total sales in previous FY)	If turnover of the business carried on by buyer exceeds INR 100 million (~USD 1,367,000) during the previous FY	Includes total sales, gross receipts or turnover
Applicability threshold for transaction value (consideration paid)	If value of goods (or aggregated value of goods) exceeds INR 5 million (USD 68,500) during any previous year	Per seller basis (i.e., aggregated value of goods from one seller has to exceed threshold)
Credit Availability	Credit of income in the books of account of person liable to pay income, shall be deemed to be the credit of such income to the account of the payee.	
Tax Rate	0.1 percent of sum exceeding INR 5 million (~USD 68,000) in value	
Date of Effect	July 1, 2021	Only applicable on sale consideration received on / after July 1, 2021
Exclusion	Shall not apply on transactions where: (i) Tax is deductible under different provisions (ii) Tax is collectible under Section 206C	Exception: Transactions which are subject to tax collected at source under Section 206C(1H) however will also be liable to deduct tax under Section 194 Q.

Analysis

- This section is similar in structure to Section 206C(1H) which was introduced through FA,2020, to collect tax at source on consideration received from the buyer. The thresholds of applicability, rate and exclusions too are largely similar and so are the issues.
- While Section 206C(1H) imposes a liability on the seller to collect tax from the buyer (i.e., the tax incidence falls on the buyer); Section 194Q, on the other hand imposes a liability on the buyer to deduct tax while paying to the seller (i.e., tax incidence falls on the seller). This would mean that there is now a possibility of a two-way collection from the buyer and the seller both on sale of goods domestically on the same transaction which exceed the specified thresholds in both these sections (i.e., transaction value / aggregate transaction value has to exceed INR 5 million i.e. (~USD 68,500)).
- However, it is important to note that for Section 194Q to apply a Buyer should qualify for the thresholds set out above and the seller should has to be a resident.
- Under Section 194Q, while the buyer withholds tax during payment to seller, there would credit available to the seller; similarly, under Section 206C(1H), while the seller collects from buyer, buyer would have credit available.

Missed Opportunities

- Clarity around the scope of the term 'goods' which are covered under tax collected at source ("**TCS**") and TDS provisions under Section 206C(1H) and Section 194O, respectively, is required to increase tax certainty and restrict the scope of application of these provisions. While the Finance Bill, 2021 failed to issue any clarity in this regard, the provisions have however used the same language in the newly introduced Section 194Q, implying that the confusion surrounding the scope of "goods" will remain, and continue to cause uncertainty through this provision as well.
- Courts have held that the meaning of the word "goods" includes shares[7], electricity[8], licenses and scrips[9], canned software incorporated in a media[10], but would not include debentures and other debt instruments[11]. Certain observations in the *Tata Consultancy Service Ltd.* v. *State of Andhra Pradesh* case demonstrate that intangible moveable property can also be goods irrespective of the medium.
- These raise questions around whether certain transactions in unlisted shares would be covered within the scope of this section. Typically, if the sole activity of the buyer is buying shares as investment and buying / selling shares as investment, they should not be considered to be conducting a business. Further, if the buyer has other business activities (apart from investing in shares), although not free from doubt, provisions should still arguably not apply since the primary activity is that of investment. However, if the buyer is trading in shares (subject to meeting the financial limit prescribed above), the provision may be applicable.
- The object of these provisions, including Section 206C of the ITA may not have been to cover financial transactions. However, a circular of the Central Board of Direct Taxes ("**CBDT**")[12] clarified that only transactions in securities and commodities which are traded on a recognized stock exchange, or are cleared and settled by a recognised clearing corporations, will not be covered under Section 206C(1H); these remain unresolved yet again.
- Further, even in the context of slump sales and other forms of business acquisitions, adequate indemnities may be required to ensure that the acquirer is protected in the event tax credit is not available for any reason. When the business is transferred, or is proposed to be transferred on a certain date in the future, issues could arise with respect to any withholding that is required to be done and availability of tax credit for operations in the interim.

SECTION 196 D

Section 196D of the ITA provides that where any sum is payable to a FPI in the nature of income received in respect of securities (other than units referred to in Section 115AB) or capital gains arising from the transfer of such securities, then TDS shall be applicable at the rate of 20 percent. As the rate of TDS is specifically set out under the section, a more beneficial tax rate provided under the relevant tax treaty cannot be applied. In light of representations from stakeholders requesting that more beneficial treaty rates be applicable for payment made to FPIs, the Budget proposes to add a proviso to Section 196 which provides that tax treaty rate of deduction will be applicable if the FPI furnishes the tax residency certificate required under Section 90(4) or 90A(4) of the ITA. This much awaited amendment is intended to take effect from April 1, 2021, and would help avoid situations where the FPI would have to request for tax refunds in case tax at higher rates would have been withheld.

'GOODWILL' BECOMES A NON-DEPRECIABLE ASSET

In a mergers and acquisitions ("**M&A**") context, the availability of depreciation on acquired goodwill has often been a key question. It is not unusual for the acquirer to pay a consideration in excess of net asset value for a business, and this excess has typically been regarded as a payment for the acquisition of the 'goodwill' attendant to the business acquired – an intangible asset generated by virtue of the good business practices and a strong reputation.

The answer to this question, until now, has been the subject of some debate. In 2012, the Supreme Court ruled[13] *simpliciter* that goodwill is a depreciable asset and subsequently, taxpayers have generally been able to claim depreciation on goodwill in the context of business acquisitions and slump sales. However, the wording of several sections of the ITA[14], which the Supreme Court did not consider in its decision, left in doubt the exact quantum of depreciation that a taxpayer would be able to claim on acquired goodwill in a merger context.

For example, Explanations 7 and 7A to Section 43(1) provided that where, pursuant to a merger, a capital asset is transferred by the merging company to the merged company, the actual cost of the transferred capital asset to the merged company will be the same as it would have been if the merging company had continued to hold the capital asset for purposes of its own business.

This and similar provisions have been interpreted by the Indian tax authorities to imply that, pursuant to a merger, the surviving company would only be eligible to claim depreciation on assets in respect of which the merging company was entitled to claim depreciation. Since goodwill is a self-generated asset and did not exist as an asset on the books of the merging company, the merging company would not have been entitled to claim depreciation on goodwill. Taxpayers on the other hand argued that the consideration paid in excess of the net asset value of a business could be recognized as the cost of acquisition of goodwill, be serve as a base for depreciation, especially where such recognition was permitted by applicable accounting principles.

Tribunals however, have been divided on the matter.[15] While there have been some judgments in favour of the taxpayer, the Indian tax authorities have appealed these rulings.

Changes proposed by the Budget, set to come into effect from April 1, 2021, lay the debate to rest by simply excluding goodwill from the ambit of depreciable assets. The changes will be applicable to M&A transactions across the board.

Further, the proposed changes provide for depreciation already claimed on acquired goodwill will be reduced from the cost of acquisition of such goodwill, which will result in a reduction of the cost base, and a consequent increase or decrease in future capital gains or losses respectively.

The proposed changes also seek to exclude goodwill from the definition of "block of assets" with effect from April 1, 2022, and in the interim i.e., with effect from April 1, 2021, make provision for the issuance, by the CBDT, of specific rules for the computation of capital gains arising from the transfer of a block of assets that includes goodwill.

The Memorandum to the Budget argues that since, depending on a how a business runs, goodwill may see appreciation or no depreciation in its value. Therefore, the Memorandum concludes, there is no justification for goodwill to be treated on par with other intangible assets and plant and machinery when it comes to depreciation. This is despite the fact that an applicable accounting standard may nonetheless require recognition of goodwill, and its subsequent impairment.

While the Government has effectively overruled a taxpayer friendly ruling of the Supreme Court, the proposed changes do serve to bring closure to the issue of the availability depreciation on goodwill. However, since the proposed changes are prospective in their applicability, the fate of the appeals filed by the Indian tax authorities remains to be seen.

Parties to transactions negotiated or consummated on the basis of certain assumptions or positions with respect to the availability of depreciation on goodwill may also consider the need for appropriate purchase price adjustments.

SLUMP EXCHANGES SUBJECT TO SLUMP SALE TAXATION

A transfer of a business undertaking as a result of a "sale" for a lumpsum consideration is referred to as a 'slump sale' in the ITA. A simplified computation method, and potentially lower tax rate make slump sales attractive. For example, a seller can avail a concessional tax rate for capital gains where the business undertaking being sold has been held for more than 3 years (even if the assets of that undertaking have been held for a shorter period). Additionally, the taxable 'gains' in case of a slump sale are computed as the difference between the sale consideration and the *net worth* of the business undertaking, as opposed to the underlying *cost of acquisition* of each asset. Further, exemption from Goods and Services Tax makes a slump sale a popular mechanism of business transfers.

The contours of a slump sale and taxpayers' eligibility for its benefits have been litigious. One of the issues concerning slump sales was whether they included only a 'sale' for monetary consideration or also other forms of 'transfer' – such as an exchange of the business undertaking for other assets such as shares of the purchaser entity. Case law from different High Courts on this issue had been inconsistent.[16]

The definition of a slump sale has been amended in the Budget to put this controversy to rest. It replaces the word 'sale', and instead defines the term to include the transfer of an undertaking "by any means". The term 'transfer' has been defined broadly under the ITA to include specifically an 'exchange', 'relinquishment' and 'extinguishment'.

The latitude of this definition can be appreciated in light of a Supreme Court decision in which it held that the rights of shareholders of a merging entity are "transferred" because of the "extinguishment" of their shares in the process of a merger.[17] This clarification brings certainty with respect to the scope of the term 'slump sale', and allows for tax efficient transactions without the risk of litigation.

According to the Memorandum to the Finance Bill the unintended ambiguity with respect to the interpretation of a slump sale had caused taxpayers to disguise other forms of transfer as cash transactions. Noting the original intention, however, it also notes that the original definition of a slump sale also applied to transactions that are sales 'in effect and substance'. The amendment is intended merely to clarify this.

Taxpayers were taking a view that a slump exchange is not a taxable transaction given that specific provisions applicable in slump sale did not apply to an "exchange", and the cost of the undertaking could hence not be determined. The proposed change rests the controversy by providing all slump sale transactions as taxable. However, ambiguities on other aspects pertaining to slump sales remain – such as the applicability of Section 56 of the ITA to the recipient of the undertaking, qualification of "lumpsum' criteria in case of multiple payments based on milestones, etc - on which certainty would be welcome to make this mode of alienation more attractive.

ADVANCE RULINGS FRAMEWORK - OVERHAULED!

The Authority for Advance Rulings ("**AAR**") is a quasi-judicial tribunal set up in 1993 with the specific aim to provide certainty to non-resident investors on their Indian tax incidence. However, over the last decade or so, the AAR has accumulated a large backlog of pending cases. While the statutory requirement is for the AAR to pronounce a ruling within six months, it practically takes at least 5-6 years from the date of application for a final ruling to be delivered. The Finance Memorandum has recognized that the positions of Chairman and Vice-Chairman have remained vacant due to non-availability of eligible persons (being retired Supreme Court and High Court judges). Owing to these vacancies, the AAR has not been functioning in an efficient manner and the Budget proposes to re-look at the system in line with its objective of promoting efficiency in tax administration. Finance Bill proposes to do away with operation of the AAR and replace it with the Board for Advance Rulings ("**BAR**").

The proposals in this regard have been set out below:

- AAR shall cease to exist: It is proposed that the AAR shall cease to operate from a date notified by the Central Government.
- Constitution of BAR: A new provision, Section 245-OB is proposed to be introduced which will give the Central Government power to constitute one or more BARs. It is proposed that the BAR shall consist of two members, each being an officer not below the rank of Chief Commissioner. It is proposed that the BAR shall be constituted on a date notified by the Central Government. Currently, the AAR has three benches which are chaired by a retired Supreme Court judge or a retired high court judge. The other members included a law member and a revenue member. At this stage, the number and location of the benches of the BAR are not specified and should be clear once the notification is released.
- Transfer of cases: To cater to the backlog of cases at the AAR, a new provision Section 245P has been proposed under which all pending applications where (i) no admission order of the AAR has been passed or (ii) no final order has been passed, will be transferred from the AAR to the BAR (once constituted). The introduction of this section appears to be in line with the intention of clearing the backlog of cases.
- New Scheme: The Finance Bill proposes to include a provision giving the Central Government the power to make a scheme for greater efficiency of the BAR process by (i) eliminating the interface between the applicant and the BAR to the extent feasible, (ii) optimal utilization of resources and (iii) introducing a system with dynamic jurisdiction. Depending on the contents of the new scheme, the Central Government may (before March 31, 2023) direct that certain provisions of the ITA may be deleted or modified. While these appears to be measures for effective tax administration, the notification will give greater insights on how (ii) and (iii) are practically proposed to be achieved.
- Same provisions applicable to BAR: Section 245R provides the procedure to be followed by the AAR for examining an advance ruling application, including criteria for admission and pronouncement of the ruling and time limit for pronouncement of ruling. It is proposed that these provisions shall apply to the BAR (once constituted). It is also proposed that proceedings before the BAR be considered as judicial proceedings for the purposes of certain sections of the Indian Penal Code[18] and have certain powers of a civil court as under the Civil Procedure Code[19], similar to the proceedings of the AAR. However, it is proposed that the provision enabling the AAR to regulate its own procedure shall not be made applicable to the BAR.
- Non-binding ruling: Currently, statutorily, the ruling of the AAR is binding on the tax department and the applicant. It is proposed that this provision be deleted and not be made applicable to the BAR.
- Appeal: A new provision on appeal has been proposed under the Finance Bill. Under this, an appeal from a ruling of the BAR is available to the taxpayer to the High Court, within 60 days of date of communication of the ruling. The High Court may grant a further period of thirty days in certain cases. It is proposed that a scheme by notification by the Central Government may also be made for the purposes of filing of appeal by the tax officer against the ruling of the BAR where such scheme imparts greater efficiency by (i) optimising utilization of resources and (ii) introducing a team-based mechanism with dynamic jurisdiction. The Central Government may (before March 31, 2023) direct that certain modifications and adaptions be made in so far as applicability of the Act to give effect to the scheme. On the other hand, under the AAR mechanism, there is no statutory right of the taxpayer or the Revenue to appeal against the ruling of the AAR. However, a constitutional remedy of filing a writ petition before the High Court is available to the parties.
- Grandfathering: It is proposed that all previous advance rulings pronounced under Section 245R will be been grandfathered and the amendments proposed in Finance Bill shall not apply to such rulings. This should cover both admission orders and final rulings.

In effect, the Finance Bill proposes to change the unique nature of the AAR where rulings were binding on the parties and delivered by a retired Judge into a one where rulings are non-binding and delivered by the Revenue. The latter system of private letter rulings is prevalent in most jurisdictions such as USA, UK and Ireland. In line with the global system of private rulings, the advance ruling pronounced by the BAR will not be binding on the taxpayer or the revenue. It is yet to be seen how far the adversarial nature of the process is retained; the fine print of the notifications issued by the Central Government will provide more clarity on this. Every notification issued shall be laid before the parliament.

It is also unclear to what extent the BAR will function as a quasi-judicial tribunal. The Finance Bill proposes to include provisions that state that every proceeding before the BAR shall be deemed to be a judicial proceeding for the purposes of certain provisions of the Indian Penal Code. It is unclear on whether BAR could qualify as a tribunal carrying out judicial proceedings in the absence of the appointment of judicial members[20]. It is also worthwhile to consider whether a different approach could have been taken to retain the current framework of the AAR by relaxing the eligibility criteria of the members, especially since the Supreme Court has directed the setting up of National Tribunal Commission for appointment of members in various tribunals.

This proposal is a major blow for existing taxpayers who have approached the AAR to obtain tax certainty on complex international tax questions with an expectation of a binding ruling by a tribunal. The relegation of the AAR to BAR makes the system a lot less attractive to foreign taxpayers since the rulings are not binding and the process is no longer one which will be examined from the viewpoint of a fair and unbiased retired High Court / Supreme Court judge. This is especially concerning since the entire case load of the AAR is proposed to be transferred to the BAR.

Importantly, it is proposed that there shall be no statutory provision stating that the ruling pronounced by the BAR shall be binding on the parties. While this proposed omission may have been made to introduce an appeal mechanism, it may result in confusion. For e.g. if a taxpayer gets a favourable advance ruling, can the tax department initiate regular tax proceedings against the applicant? Logically, the tax department should respect the ruling of the BAR but in the absence of clear provisions, ambiguity remains. It is also not clear how the appeal process will tie in with the existing tax assessment process adopted by the Revenue. or the circumstances and timelines under which such appeal right can be exercised.

Having said that, the advance ruling mechanism may still be a chosen mode of dispute resolution to resolve large tax disputes if it can enable them to directly approach the High Court after an unfavourable ruling from the BAR, without having to go through the long and arduous regular tax assessment process which typically takes 10-15 years. Given that the time limit of six months for pronouncement of ruling is proposed to be applicable to the BAR, it is hoped that the objective of administrative efficiency is met and the timeline is strictly followed going forward.

Currently, for transfer pricing and international tax matters, it is possible for the taxpayer to choose the Dispute Resolution Panel (DRP) mechanism, a time-bound process which enables the taxpayer to directly make an appeal to the Income-tax tribunal from the assessing officer's ("**AO**") order, once DRP issues directions to the AO. While in most cases, the DRP's directions are not effective in providing taxpayers' relief, taxpayers can use this mechanism as a fast track method for getting heard before the tribunal. It is hoped that such efficiency in meeting the prescribed timelines is also followed by the BAR.

Overall, with several questions still unanswered, it is unclear on how effective the new BAR framework will be vis-a-vis the current AAR framework, considering that administrative efficiency was the driving factor behind this move.

DISPUTE RESOLUTION

Re-haul of the provisions related to income escaping assessment / search assessments

Section 147 of the ITA provides that if the AO has reason to believe that any income chargeable to tax has escaped assessment for any AY, he may assess, re-assess or re-compute such income by issuing a notice under Section 148 of the ITA. Assessment / re-assessment in cases where search is initiated is governed by a separate set of provisions including Sections 153A, 153B, 153C and 153D. Owing to the time frames allowed under these provisions for the AO to complete assessments (generally 4 to 6 years), taxpayers face uncertainty regarding their tax positions for long periods of time.

Due tDue to the advancement in technology, income escaping assessments / search assessments to a large extent has become information driven. Recognizing the same, the Budget has proposed to completely reform the system of income escaping assessment / search assessments. Some of the salient features of the proposed reformed system are as below:

- All kinds of assessment / re-assessment cases under the ITA to come within the purview of the revamped Section 147 of the ITA. As such, even the assessment / re-assessment in search related cases to come within the purview of Section 147. Search cases initiated on or before March 31, 2021, however, to continue to be governed under the erstwhile provisions, i.e. Sections 153A, 153B, 153C and 153D.
- Section 147 proceedings can only be initiated when the AO has 'information which suggests that the income chargeable to tax has escaped assessment' and prior approval of the specified authority is obtained. In this regard, 'information which suggests that income has escaped assessment' has been defined to mean (i) any information flagged in case of the taxpayer in accordance with the risk management strategy formulated by the CBDT; (ii) any final objection raised by the Comptroller and Auditor General of India ("**CAG**") to the effect that the assessment has not been made in accordance with the provisions of the ITA.
- In search, survey or requisition cases initiated or made or conducted on or after April 1, 2021, it shall be deemed that the AO has 'information that suggests that income has escaped assessment' for 3 AYs immediately preceding the AY in which the search is initiated, or requisition is made or any material is seized or requisition or survey is conducted.
- A new Section 148A is proposed to be introduced in the ITA, as per which, prior to initiating proceedings under Section 147, the AO shall conduct enquiries, if required, and provide an opportunity to the taxpayer of being heard, pursuant to obtaining approval of the specified authority. This however, should not apply to search or requisition cases.
- Once assessment, re-assessment or re-computation has started, the AO is empowered to assess or re-assess income in case of any issue which subsequently comes to his notice, even if the procedure under Section 148A (in terms of providing an opportunity of being heard and obtaining necessary approvals) is not followed in respect of such income.
- Importantly, the time limits for income escaping assessments / search assessments have been reformed as below:
  - In normal cases, no notice shall be issued under Section 148 of the ITA if 3 years have lapsed from the period of relevant AY.
  - In cases of search, requisition or survey where the AO has in his possession books of accounts or other documents or evidence which reveal that the income chargeable to tax, represented in the form of asset, which

has escaped assessment amounts to or is likely to amount to INR 5 million (USD 68,500), notice can be issued beyond 3 years but not beyond 10 AYs from the end of the relevant AY.

- Notice under Section 148 cannot be issued for AY beginning on before April 1, 2021, if such notice could not be issued on account of time limits prescribed under the un-amended provisions.
- For the purposes of computing the time-limit under Section 148 of the ITA, the time allowed to the taxpayer in providing opportunity of being heard or periods during which such proceedings are stayed by a court, shall be excluded.

As can be inferred from the above, the crux of Section 147 of the ITA has been revamped. Earlier, for re-assessment proceedings to be initiated, the pre-requisite was for the AO to have a ‘reason to believe’. However, as per the revamped provisions, the pre-requisite now is for the AO to have ‘information which suggests that income chargeable to tax has escaped assessment’, which as discussed above, has been clearly defined. The earlier threshold of ‘reason to believe’ was vague and subjective which led to widespread litigation on the matter. Considering that the newly introduced threshold of ‘information which suggests that income chargeable to tax has escaped assessment’ has been defined, it is likely to reduce litigation in this regard.

In terms of the timelines, the amendments proposed are a welcome move. The general time limit of 6 years are reduced to 3 years. While a 10 year limit has also been introduced, it is only restricted to certain cases of search, seizure or requisition, which generally are done in cases where there is a likelihood of a mala-fide intent of evading taxes. This is also likely to favorably impact M&A deals where negotiation of tax indemnities has been a moot point lately.

One concern which arises is the limitation period for passing an order deeming a person to be an ‘assessee in default’ under Section 201 of the ITA. Earlier, in the absence of any limitation period under Section 201 of the ITA, the ITAT, Mumbai (Special Bench) in the case of *Mahindra and Mahindra Ltd.*[21] had held that order under Section 201 is akin to assessment and assessment includes re-assessment, so the time limits under Section 201 have to be similar to the time limits under Section 147 of the ITA, i.e. an outer limit of 6 years from the relevant AY. Following this, Section 201 of the ITA was amended to set out the outer limit for passing an order under Section 201 of ITA to be 6 years from the relevant AY. Considering that the time limit under Section 147 of the ITA formed the basis of setting the time limit under Section 201 of the ITA, a similar change should have been brought about to the time limits under Section 201 of the ITA.

Another interesting and welcome move is the removal of a special time period of 16 years applicable in case of income in relation to any asset located outside India, escaping assessment in India. Thus, cases of indirect transfers would also get covered by the reduced period of 3 years as discussed above.

Reduction of time limit for completing assessments

Vide Finance Act, 2017, the time limit for completing assessments (reckoned from the end of the relevant AY in which the income was first assessable) under Sections 143 and 144 of the ITA were reduced from 21 months to 18 months for AY 2018-19 and 12 months for AY 2019-20 onwards. Owing to the efficiency in conducting assessments brought about by the Faceless Assessment Scheme introduced in 2019, the Budget has proposed to reduce the time limit for completion of assessments to 9 months from the end of the AY in which the income was first assessable for AY 2021-22 onwards.

This is a welcome move which will likely put pressure on the tax authorities in completing assessments in a timely manner.

Faceless ITAT

With a view of maximizing the use of technology to improve dispute resolution, the Government has in the recent past introduced measures such as faceless assessment scheme, faceless appeal scheme and faceless penalty scheme. Until now, the faceless mechanisms have only been introduced for the administrative levels, i.e. the AO and the Commissioner of Income Tax (Appeals).

The Budget proposes to introduce a faceless scheme for the ITAT proceedings as well. The idea is for the Central Government to notify a scheme for faceless disposal of appeals by the ITAT to impart greater efficiency, transparency and accountability by way of eliminating interface between the ITAT and the parties to the extent technologically feasible, optimizing utilization of resources through economies of scale and functional specialisation and introducing an appellate system with dynamic jurisdiction.

For the purposes of operationalizing the idea of faceless ITAT, the Central Government may amend the applicability of certain provisions under the ITA. However, no such amendments shall be made after March 31, 2023. Every such amendment shall be passed only after due deliberation by both houses of the Parliament.

Globally, dispute resolution involves much more importance being given to written submissions. In India however, it is the oral arguments which are considered to be more important. Faceless ITAT will result in more emphasis on written submissions, in line with global standards. Having said that, question arises whether oral arguments would be discretionary, or mandatory if requested by either party. This question is important from the perspective of principles of natural justice where if either party is requesting to be heard orally, such a request should be honored.

Further, the faceless appeals scheme up to the administrative levels are still under a nascent stage, the success of which is yet to determined. Just as in case of virtual hearings introduced during the pandemic, not all tax professionals are technologically equipped yet to handle faceless appeals. The same issue is likely to crop up with faceless ITAT as well. For this reason, the Government should have shown some patience in introducing the faceless ITAT, and introduced the same only after carefully studying and analyzing the success of faceless appeals at the administrative levels.

Formation of the Dispute Resolution Committee for small and medium taxpayers

In the recent past the Government has been taking steps such as faceless assessment at the administrative levels, Vivad se Vishwas Scheme (a scheme to settle pending tax disputes) etc. to streamline dispute resolution insofar as tax cases are concerned. Following the spirit of the same and with a view to reduce future disputes from fresh assessments in case of small and medium taxpayers, the Budget proposes to introduce a scheme to settle cases at the initial stages.

Under the new scheme, the Central Government shall constitute one or more Dispute Resolution Committee (s) ("**DRC**"), which shall resolve disputes of such persons or class or persons as may be specified by the CBDT. To have the disputes resolved by the DRC shall be at the discretion of the taxpayers. Given that the scheme is introduced only for small and medium taxpayers, it is proposed to only be applicable to those disputes where the returned income is INR 5 million (USD 68,500) or less and the aggregate amount of variation proposed in the assessment order INR 1 million (USD 13,695) or less. Further, search/ survey / reqjuisition cases would not be eligible to approach for DRC for settlement. The DRC shall have the power to reduce or waive any penalty imposable under the ITA or grant immunity from prosecution for any offence under the laws to be specified. The Central Government is empowered to bring about amendments for the operationalization of the DRC, pursuant to them being tabled before both houses of the Parliament.

The goal sought to be achieved through the DRC is commendable. One of the hallmarks of a good business environment is an effective dispute resolution mechanism. The concern however is the effective implementation of this idea. Take for example the Vivad se Vishwas scheme. While it is being branded by the Government as a success, taxpayers have faced several hurdles in availing it because of the inefficiency of the provisions, which required several rounds of amendments and FAQs to be released by the CBDT. In light of this, the expectation is that the Government takes robust measures for effective implementation of dispute resolution by the DRC, just so that the vision is not compromised in the process.

Discontinuation of the Income-tax Settlement Commission

In light of newly introduced mechanisms such as the Vivad se Vishwas Scheme and the DRC for settlement of tax cases, the Budget proposes to discontinue the age old Income-tax Settlement Commission ("**ITSC**"). It is proposed to constitute one or more interim boards for the settlement of pending cases.

It is also proposed to allow taxpayers to withdraw applications pending with the ITSC. In case of such withdrawal, the application shall stand abated and the AO before whom the proceeding was pending prior to the application to the ITSC shall dispose of the matter in accordance with the relevant provisions of the ITA.

The Central Government is empowered to bring about any such amendments as may be required to operationalize the discontinuation of the Settlement Commission, pursuant to them being tabled before both houses

SECTION 206AB, 206CCA AND 196D

Section 206AA and Section 206CC

Sections 206AA and 206CC of the ITA provide for higher rates of withholding tax (in the form of TDS or TCS, respectively), in instances where the person entitled to receive the sum of money fails to furnish a Permanent Account Number ("**PAN**") to the person making the payment. Acknowledging how these provisions have helped to motivate tax payers to obtain a PAN, the Government now proposes to insert new Sections 206AB and 206CCA to similarly motivate tax payers to file income tax returns. Accordingly, these new provisions provide higher rates of withholding tax (in the form of TDS or TCS, respectively) in instances where the person entitled to receive the sum of money:

1. has not filed the returns of income for both of the two assessment years ("**AYs**") relevant to the two previous years immediately prior to the previous year in which tax is required to be deducted,
2. has an aggregate of tax deducted at source and tax collected at source of INR 50,000 or more in each of these two previous years; and
3. for whom the time limit of filing return of income under Section 139(1) has expired.

It is further clarified that these provisions shall not apply to

1. non-residents who do not have a permanent establishment in India (ie. a fixed place of business in India through which the business of the enterprise is wholly or partly carried on)
2. taxes deducted at source pursuant to Sections 192, 192A, 194B, 194BB, 194LBC or 194N of the ITA.

In the event that a tax payer qualifies as a Specified Person under Section 206AB, TDS is proposed to be withheld at the higher of the following rates:

1. at twice the rate specified in the relevant provision of the ITA; or
2. at twice the rate or rates in force; or
3. at the rate of 5 percent

Similarly, in the event that a tax payer qualifies as a Specified Person under Section 206CCA, TCS is proposed be collected at the higher of the following rates:

1. at twice the rate specified in the relevant provision of the ITA; or
2. at the rate of 5 percent

It is also clarified that if the provisions of both Section 206AA and 206AA or 206CC and 206CCA are applicable, then the higher rate of tax in the relevant section shall be applicable.

While the Government's effort to incentivize filing income tax returns may be understandable, the proposed Sections 206AB and 206CCA actually place an additional burden on the person making the payment to determine whether the recipient qualifies as a Specified Person or not before determining the rate at which TDS or TCS should be applied. Moreover, the exemption for non-residents who do not have a permanent establishment in India could also result in disputes, with tax authorities arguing that the non-resident has a permanent establishment and should be subject to the higher rates of TDS / TCS. While such disputes are pending, the persons liable to withhold would be left with uncertainty with respect to the applicable rate of TDS / TCS.

CAPITAL GAINS ON DISTRIBUTIONS BY FIRM – NEW COMPUTATION MECHANISM PROPOSED

Distribution of capital assets to partners on dissolution of a firm (being a general partnership or an LLP), or to members on dissolution of an AOP or a body of individuals ("**BOI**"), renders the firm, AOP or BOI taxable on capital gain under the present provisions in the ITA. For computing the capital gain, the FMV of the asset on the date of transfer is regarded as the 'full value of consideration'.

The Memorandum to the Finance Bill recognises that the existing provision is ambiguous with regard to self-generated assets of the entity, and situations where assets are revalued, such that distributions to partners are in excess of their capital contributions.

The Budget proposes to replace the existing provision in its entirety, with a new code for taxation of dissolution and reconstitution of such entities. The new provisions envisage taxability in two scenarios where a partner or member receives a capital asset at the time of dissolution or reconstitution of the entity:

Where the capital asset represents the balance in the capital account of the person in the books of the entity (without considering increase due to revaluation of assets or self-generated assets):

1. the entity would be taxable on capital gains in the financial year in which the asset is received by the person,
2. the FMV of the asset on the date of receipt would be the full value of consideration for computing capital gain, and
3. the cost of acquisition of the asset is to be determined as per the extant ITA provisions.

Where the money or other asset is in excess of the balance in the capital account of the individual in the books of the entity:

4. the entity would be taxable on capital gains in the financial year in which the asset is received by the person,
5. the money or FMV of the asset on the date of receipt would be the full value of consideration for computing capital gain, and
6. the balance in the capital account of the person (calculated without considering increases due to revaluation of assets or due to any self-generated assets) will be deemed to be the cost of acquisition.

Section 48 of the ITA is also proposed to be amended to provide for a step-up of amounts taxed on dissolution and reconstitution, in order to ensure there is no double taxation. However, there appears to be a discord in the text of the amendments, which can lead to potential litigation.

The very taxability of distributions by firms has been an issue subject to extensive legal debate under the existing provision as well. Courts in India have been questioning the very existence of a 'transfer' in case of distribution of assets on the dissolution of a firm, arguing that what occurs is at best a notional sale and not really a transfer even considering the wide definition of the term under the ITA.[22] In fact, the Supreme Court specifically upheld a decision of the Gujarat High Court holding that a distribution of a share in the value of goodwill, a self-generated asset, to a retiring partner was not a 'transfer' within the meaning of Section 2(47) of the ITA, and hence was not subject to capital gains tax.[23] The proposed amendments do not address this issue. In the same vein, while the existing Section 45(4) of the ITA applies to dissolution, the amendments seek to apply the new provisions to 'reconstitution' of the firms / AOP / BOI as well. This begs the same question as to what in the minds of the lawmakers is the 'transfer' involved in a reconstitution that amounts to a taxable event giving rise to capital gains tax incidence.

MAT PROVISIONS RATIONALISED

The meaning of "book profits" for purposes of computing minimum alternate tax ("**MAT**") is quite complicated owing to a long list of additions and removals required to be made under the ITA. The Budget proposes to amend the MAT provisions under the ITA in the following manner:

Amendment to treat dividend income of foreign company at par with royalty and FTS

- Dividend income arising to a foreign company, chargeable to tax at a special rate under the ITA, is now to be reduced from 'book profits' where such income has been credited to the company's Profit and Loss Statement ("**P&L**"). Correspondingly, expenditure incurred by the foreign company in relation to such dividend income that is debited from the P&L is to be added back to the book profits of the company.
- This amendment seeks to bring dividend income at par with other streams of income like royalty and fees for technical services that are taxed on source basis at specified rates under the ITA for non-residents. Since the removal of the DDT via the FA, 2020, the non-resident receiving the dividend is no longer exempt from tax under the ITA and the taxation of dividends paid to non-residents has reverted to the classical withholding tax system that is applied for royalty and FTS income. Accordingly, it is only befitting that the MAT provisions treat dividend income of a foreign company at par with royalty and FTS income.

New provision to consider enhancement in book profit due to past year income

- Where an increase in the book profit of a company for a financial year is attributable to income of earlier years added to that financial year's book profits, the Budget proposes that such company can now apply to the income tax officer to recompute the book profits of previous years along with tax payable. This would apply where the current year increase is due to (a) an APA entered by the company with the Indian Government, or (b) a secondary transfer pricing adjustment made to the books of the company pursuant to a primary transfer pricing adjustment. The mechanism for passing orders for 'rectification of mistake' under Section 154 of the ITA would apply to the extent feasible, and the 4-year limitation period for amendment of orders under Section 154 is to be regarded from the end of the financial year in which the tax officer receives the aforementioned application.
- While a welcome provision, the manner in which the tax officer is to recompute the income of earlier years is yet to be prescribed. With regard to the rectification of orders under Section 154, it is unclear whether the timeline provided for under the proposed amendment (four years from end of the FY in which the tax officer receives the application) can override the timeline already specified in Section 154 (expiry of four years from the end of the FY in which the order sought to be amended was passed). A question would arise in respect of matters where the timeline for rectification under Section 154 has already expired, and whether in such situations the new provision can operate to revive such an expired timeline.

RESTRICTIONS ON AVAILING ZERO RATING BENEFITS UNDER GST REGIME

The Finance Act 2021 has introduced an amendment to Section 16 of the Integrated Goods and Services ("**IGST Act**"), specifically within sub-section (3) which lays down the options for a registered person making zero rated supplies, to claim credit of input tax. Previously there were two options available under Section 16(3), namely:

"*A registered person making zero rated supply shall be eligible to claim refund under either of the following options, namely:—*

1. *he may supply goods or services or both under bond or Letter of Undertaking subject to such conditions, safeguards and procedure as may be prescribed, without payment of integrated tax and claim refund of unutilised input tax credit;* ***or***
2. *he may supply goods or services or both, subject to such conditions, safeguards and procedure as may be prescribed, on payment of integrated tax and claim refund of such tax paid on goods or services or both supplied,"*

The Finance Bill 2021, through its amendment has done away the mechanism under sub-section (b), i.e., to charge IGST on the export invoice and utilize the underlying input credit in setting off the output liability. A new sub-section (3) to Section 16 of IGST has been substituted in place of the previous dual options. The text of the same is as provided below:

"(*3) A registered person making zero rated supply shall be eligible to claim refund of unutilised input tax credit on supply of goods or services or both, without payment of integrated tax, under bond or Letter of Undertaking, in accordance with the provisions of section 54 of the Central Goods and Services Tax Act or the rules made thereunder, subject to such conditions, safeguards and procedure as maybe prescribed:*

Provided that the registered person making zero rated supply of goods shall, in case of non-realisation of sale proceeds, be liable to deposit the refund so received under this sub-section along with the applicable interest under section 50 of the Central Goods and Services Tax Act within thirty days after the expiry of the time limit prescribed under the Foreign Exchange Management Act, 1999 for receipt of foreign exchange remittances, in such manner as may be prescribed."

This sub-section retains the mechanism for claiming input tax credit under the previous subsection (a), while adding the refund mechanism under Section 54 of the Central Goods and Services Act ("**CGST Act**") i.e., exporting goods or services without any payment of GST, using a bond or Letter of Undertaking; and then subsequently claiming the unutilised input credit as refund under Section 54.

The *proviso* further lays down that if the export receipt is not realized then the refund amount has to be deposited, along with interest under Section 50 of CGST Act, within 30 days of the expiry of the time period provided under FEMA Act, 1999, for realization of such receipt (generally 9 months).

Newly introduced sub-section (4) also leaves a window open for restricting the zero-rated supply on payment of IGST, only to such class of taxpayers, or such supplies of goods / services as is notified by the Government.

Analysis

Promotion of exports has been a key policy objective for the Government; and the annual budget usually contains provisions specifically geared to address it. These changes are meant to streamline and plug certain issues that arose with respect to claiming of refund of credits in export transactions. Nevertheless, with regard to continuous supply of services, specifically inter-company transactions, it may be beneficial to restructure the invoicing mechanism on monthly to an annual basis, in order to streamline the payments and the refund process, particularly considering the limitation proposed above with respect to receiving remittances within a certain period of time to be eligible for the benefit.

Secondly, the amendment to options in claiming input credit as per newly introduced sub-section (3), links the foreign exchange remittance with refund, in cases of export of goods.

- **International Tax Team**

You can direct your queries or comments to the authors

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[1] *General Electric Pension Trust v. DIT*, [2005] 280 ITR 425.

[2] Union of India v. Azadi Bachao Andolan, [2003] 263 ITR 597.

[3] In Re: Mohsinally Alimohammed Rafik, In re [1995] 213 ITR 317; In Re: Cyrille Eugene Pereira, [1999] 239 ITR 650; In Re: Abdul Razak Meman, [2005] 276 ITR 306; DIT v. Green Emirates Shipping, [2006] 100 ITD 203.

[4] *Chiron Behring GmbH & Co. v. DIT*, [2013] 351 ITR 115.

[5] *Ibid*.

[6] Dhruv Sanghavi, Structural Issues in the Income Tax Treaty Network: Towards a Coherent Framework, (Ipskamp Publishing, Nijmegen, 2018), pp. 110 and 121; see also: Joanna Wheeler, The Missing Keystone of Income Tax Treaties, Doctoral Series No. 23, (IBFD: Amsterdam, 2012), p. 253.

[7] *Vadilal Sarabhai* v. *Manekji Pestonji Bharucha,* (1923) 25 BomLR 414, decided in the context Indian Contract Act, 1872, before the Sale of Goods Act, 1930 was introduced

[8] *Karnataka Power Transmission Corporation* v. *Ashok Iron Works Pvt. Ltd.,* (2009) 3 SCC 240, decided in the context of Consumer Protection Act, 1986

[9] *Vikas Sales Corporation* v. *Commissioner of Commercial Taxes,* (1996) 4 SCC 433

[10] *Tata Consultancy Service Ltd.* v. *State of Andhra Pradesh,* (2004) 137 STC 620 (SC)

[11] *R D Goyal* v. *Reliance Industries Ltd.,* (2003) 1 SCC 81, decided in the context of Monopolies and Restrictive Trade Practices Act, 1969

[12] Circular no. 17 of 2020, CBDT

[13] See: *CIT v. Smifs Securities,* [2012] 348 ITR 302 (SC)

[14] See: the sixth proviso to section 32(1), explanation 7 to section 43(1), section 49(1)(iii)(e), and explanation 2 to section 43(6).

[15] See: *Mylan Laboratories Ltd. v. DCIT,* (2020) 180 ITD 558 (Hyd) (Trib.), and *Urmin Marketing P.Ltd. (now known as Unicom Packaging LLP v. DCIT,* ITA No. 1806/Ahd/2019, for the availability of depreciation on goodwill acquired through a merger, and *United Breweries Ltd. v. ACIT* ([2016] 76 taxmann.com 103), against.

[16] See *SREI Infrastructure Finance Ltd. v. Income Tax Settlement Commission [2012] 207 Taxman 74 (Delhi HC), CIT v. Bharat Bijlee [2014] 365 ITR 258 (Bombay HC), Areva T&D India Ltd. v. CIT [2020] 428 ITR 1 (Madras HC)*

[17] *CIT v. Grace Collis [2001] 248 ITR 323 (SC)*

[18] Sections 193, 196 and 228 of the Indian Penal Code

[19] As set out in Section 131 of the ITA

[20] Rojer Mathew v. South Indian Bank Ltd [2019] 111 taxmann.com 208 (SC)

[21] [2009] 30 SOT 374 (Mumbai) (SB)

[22] See *Malabar Fisheries Co. v. CIT [1979] 120 ITR 49 (SC)*
[23] See *ACIT v. Mohanbhai Pamabhai [1987] 165 ITR 166 (SC)*